LEGISLATIVE AUDIT COMMISSION

Review of
University of Illinois
Year Ended June 30, 2004

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REVIEW: 4231
UNIVERSITY OF ILLINOIS
YEAR ENDED JUNE 30, 2004

FINDINGS/RECOMMENDATIONS - 8

ACCEPTED - 5
IMPLEMENTED - 3

REPEATED RECOMMENDATIONS - 2

PRIOR AUDIT FINDINGS/ RECOMMENDATIONS - 7

This review summarizes the auditors' reports of the University of Illinois for the year ended June 30, 2004, filed with the Legislative Audit Commission on March 24, 2004. The auditors conducted a financial audit and compliance examination in accordance with State law and the requirements of the federal Single Audit Act and OMB Circular 133. The auditors examined the financial statements in the Annual Financial Report; and the revenue bond financial statements of the Auxiliary Facilities System, the Willard Airport Facility, and the Health Services Facilities System and stated the financial statements were fairly presented.

The University of Illinois (University) is a comprehensive university serving primarily the citizens of Illinois from three main campuses and various outreach activities. The governing body of the University is the Board of Trustees of the University of Illinois.

The Chicago campus is responsible for pursuing teaching, research and service activities related to basic and health sciences and providing a broad range of educational services at both the graduate and undergraduate levels. Vast educational offerings include professional degree programs in medicine, dentistry, pharmacy, nursing, associated health professions and public health as well as major research programs in a variety of curriculums.

The Springfield campus is responsible for addressing public affairs within the framework of a liberal arts curriculum through its first-hand access to State government and public service through special courses, projects and internship opportunities.

The Urbana-Champaign campus is responsible for pursuing instruction, including strong emphasis at the graduate level; research, through its eminent faculty; and public service as the original land grant campus of the University.

Dr. James J. Stukel was President of the University during the audit period. He retired in February 2005. The current president is Dr. B. Joseph White, who became president in February 2005. He had no prior association with the University.

General Information

Following is a summary of the net assets of the University as of June 30:

	2004	2003
Assets		
Cash and Investments	$ 364,589,000	$ 407,263,000
Accounts and note receivable	299,114,000	282,040,000
Capital assets, net of depreciation	2,746,524,000	2,547,063,000
Other assets	710,082,000	688,371,000
Total Assets	**$ 4,120,309,000**	**$ 3,924,737,000**
Total Liabilities	**$ 1,841,931,000**	**$ 1,780,868,000**
Net Assets	**$ 2,278,378,000**	**$ 2,143,869,000**

Information on full-time equivalent (FTE) enrollment of 67,376 students, employment exceeding 28,900, and per capita costs is detailed in Appendix A. Full-time student enrollment decreased about 109, and the number of full-time equivalent employees increased by 625. The increase in employees is primarily due to an increase in medical residents, interns, research assistants and teaching assistants.

Expenditures From Appropriations

Appendix B summarizes the appropriations and expenditures for the period under review. In FY04, the University received State appropriations from five funds: General Revenue Fund, Tobacco Settlement Fund, Fire Prevention Fund, State College and University Trust Fund, and Capital Development Bond Fund. Since 1996, Income Fund receipts previously retained with the State were transferred to the University. Deposits to the Income Fund for FY04 increased almost $48 million, totaling $375.4 million, a 14.6% increase over FY03. General tuition programs increased approximately 5% for all three campuses for FY04.

During FY04 the University's total expenditures were $731,930,714 from appropriated funds. According to the audit report, 93.5% of FY04 expenditures were from the General Revenue Fund; 6.1% from the Capital Development Bond Fund; and about 0.4% from the other funds. FY04 expenditures from appropriated funds were almost $58.2 million less, or 7.4% less than FY03. Expenditures from GRF increased by $46.1 million while appropriations and expenditures from the Capital Development Bond Fund dropped $59.5 million and $14.7 million, respectively. The University received no funds from the Educational Assistance Fund which provided $87.4 million to the University in FY03.

Revenues, Expenses and Changes in Net Assets

The table appearing in Appendix C presents a summary of revenues, expenses and changes in net assets at June 30, 2004 and 2003. Operating revenues, or those that generally result from exchange transactions, were $2,292,261,504. State appropriations, gifts and investments are defined as nonoperating revenues, and totaled $1,510,464,728. The University's operating expenses were $3,798,003,561. The increase in net assets was $134,509,787.

The chart appearing below shows revenues by source for FY04:

Revenues	FY04
Nonoperating revenue	40%
Grants and contracts	18%
Student tuition and fees	12%
Hospital and other medical services	10%
Auxiliary enterprises	7%
Department activities	5%
Other operating revenues	8%

The following chart indicates expenses by type for FY04. The supplemental benefit funding to SURS, which amounts to $597.2 million, appears for the first time:

Expenses	FY03
Instruction	16%
Research	14%
Support services	10%
Hospital and medical activities	9%
Public service	7%
Auxiliary enterprises	6%
Plant operations	5%
Scholarships & fellowships	4%
Depreciation	4%
On behalf payments for fringe benefits	9%
State of IL supplemental benefit funding	16%

Accounts Receivable

Appendix D provides a summary of the accounts receivable for FY04 and FY03. Total net accounts receivable increased to $284,782,888 as of June 30, 2004 from $271,606,375 as of June 30, 2003. The allowance for doubtful accounts (both unrestricted and restricted) increased, from $183,586,306 in FY03 to $205,365,000 in FY04. The entire allowance for doubtful accounts in FY04 was related to the operation of the hospitals and clinics. Net receivable for unrestricted accounts decreased $8 million, and net receivable for restricted accounts increased $13 million. Notes receivable (student loans), which total almost $63.8 million, is not included in Appendix D.

Capital Assets

Appendix E is a summary of changes in capital assets. Capital assets at the beginning of FY04, valued at $2.5 billion increased to $2.7 billion at June 30, 2004. This figure was comprised of the following:

- $117 million in land;
- $2,186.9 million in buildings;
- $383.8 million in improvements;
- $984.9 million in equipment and software;
- $510.8 million in construction in progress;
- $361.1 in library materials;
- $12.9 in inexhaustible collections; and
- Less $1,810.9 million in accumulated depreciation.

At UIC, major construction in progress consisted of $36 million for the Com Research facility and $15.7 million for south campus parking structure. At UIUC, major construction in progress consisted of $14.5 million for the Seibel Center for Computer Science, $9.8 million for campus recreation center east addition, and $13.7 million for a north campus parking deck. Major construction in progress at UIS consisted of almost $21 million for a classroom office building. Phase II student residence and the research office building at UIC were almost completed. The expanded child development laboratory and Enterprise Works @IL were completed at UIUC.

Foundation Payments to the University

During FY04 and FY03, the University engaged the University of Illinois Foundation under contract to provide fund-raising and other services. In accordance with the contract agreement, in FY04 the University provided a total of $6,377,204 to the Foundation. This compares to a total of $6,375,411 provided to the Foundation by the University in FY03. As required by the contract, the Foundation provided the University certain funds considered unrestricted for purposes of the computations outlined in the University Guidelines in 1982.

The Foundation provided a total of $122,598,712 to the University in FY04, compared to $123,592,749 in FY03. Gifts received by the Foundation include some gifts attributable to solicitations by personnel of the University. Conversely, private gifts received by the University include some gifts attributable to solicitations of Foundation personnel. Appendix F provides a summary of all funds that the Foundation gave to the University during FY04 and FY03.

Tuition and Fee Waivers

Appendix G provides a summary of tuition and fee waivers by campus. During FY04 the University of Illinois granted tuition and fee waivers valued at $164,915,800 to 17,644 students. The value of tuition and fee waivers in FY03 was $147.1 million. Of the $164.9 million in tuition and fee waivers granted in FY04, $11.2 million was for mandatory waivers and $153.7 million was for discretionary waivers. The majority of waivers, totaling $135 million in FY04, went for 11,080 various assistantships at the three campuses.

Summary of Health Care Delivery Services

Appendix H provides a summary of health care delivery services operations and a statement of revenues, expenses, and changes in net assets. The summary includes the University of Illinois Hospital and associated clinical facilities providing patient care at, but not limited to, the University of Illinois at Chicago Medical Center. In FY04, the System had operating revenues of $564.8 million and operating expenses of almost $562.4 million, and an operating income of $2.4 million.

Accountants' Findings and Recommendations

Condensed below are the eight findings and recommendations from the audit report. There were two repeated recommendations. The following recommendations are classified on the basis of information provided by Kathe Shinham, Assistant Vice President for Business and Finance, in a letter dated September 12, 2005.

Accepted or Implemented

1. Research and resolve all reconciling items on a timely basis. Establish procedures to review reconciliations in a timely manner to ensure they are being performed on a timely basis and to assist in resolving reconciling items as they occur.

Findings: The auditors noted numerous reconciling items on a student loan collection account that were left unresolved. A payroll bank account was not reconciled timely.

The fiscal year end bank account reconciliation for the student loan collection account contained several reconciling items with a net value in excess of $2 million. These reconciling items should have triggered adjustments to the accounting system. Instead they were carried forward as reconciling items from month to month, with items dating back to July 2003. In addition, the fiscal year end consolidated payroll account reconciliation with a book balance of $6.6 million was not reconciled until September 2004.

Accepted or Implemented - continued

Updated Response: Accepted. The Banner implementation required new techniques to access and analyze data required to reconcile the various memo banks. In addition, certain procedures inherent in UFAS processing did not translate to Banner. University Accounting and Financial Reporting (UAFR) staff has identified the procedural problems that created the reconciling items on the student loan collection account and implemented new procedures to accurately post all student loan transactions. Special reporting has been developed and the reconciliation has been completed.

UAFR has reconciliation procedures in place that require timely reconciliation of all bank accounts and the subsequent resolution of all reconciling items. UAFR has a monthly checklist to track the completion of bank reconciliations, including follow up on reconciling items. This checklist is reviewed by the supervising managers.

Updated Response: Implemented. The account reconciliations are current and reconciling items are being cleared on a timely basis.

2. Review procedures regarding gifts in kind to ensure that documentation is submitted in a timely manner so that gifts in kind will be recorded in the University's accounting system on a timely basis.

Findings: The auditors noted an instance in which University personnel did not record a land donation timely. A $2.4 million land gift to the University occurred in FY02, but was not recorded until FY04.

Response: Accepted. The Real Estate Planning and Services Offices understand the requirements for timely recording of all acquisitions of real estate and will coordinate their efforts with Accounting to ensure timely recording of real estate gifts and other acquisitions.

Updated Response: Implemented. Staff implemented an internal communication and reconciliation process that ensures the inclusion of capital asset additions in the Banner fixed asset system, and subsequently in the University's Annual Report and bondholders reports.

3. Follow through with the oversight procedures developed to ensure that all Statements of Appointments follow the guidelines that are set out in the Notice of Award. (Repeated-2003)

Findings: Statements of Appointments were not completed properly as required by a federal grant agreement. The Department of Health and Human Services (DHHS) requires the completion of a Statement of Appointment Trainee form for each trainee receiving grant support. The form must be completed and submitted within 30 days of the

appointment. In addition, trainee appointments can be made for no more than 12 months nor less than nine months.
The auditors reviewed the Statements of Appointment for all 65 students submitted to the Centers for Disease Control and Prevention, DHHS. Of the 65 students reviewed, 16 were not actual trainees that required a Statement of Appointment form. Of the remaining 49 students, 25 students did not have a Statement of Appointment completed and 20 students did not have a Statement of Appointment completed timely.

Updated Response: Accepted. All statements of appointments were subsequently filed for this grant. We continue to work with campus units to ensure adherence to grant guidelines.

4. Review current accounting policies and procedures related to storerooms to ensure they are accurate and up to date. Provide training to department managers to ensure they are following the accounting policies and procedures correctly. Review departmental financial information to determine if any other storerooms may be operating. Report the unauthorized storeroom financial information to the affected Federal agencies and return any documented questioned costs.

Findings: The biochemistry department was operating a storeroom that was not approved by the University and was not following University policies and procedures.

For the non-biochemistry departments, the storeroom manager would accumulate the total dollar amount of items removed from the storeroom by department, charge them a 15% mark-up cost, and prepare an internal billing sheet for the individual departments. The internal billing sheet would be sent to each department for them to complete the account codes to be charged and submit it to accounting for input into the University's accounting system. The actual direct charges to each federal grant for non-biochemistry departments appear to be allowable as the departmental personnel determined which grant should be charged; however, the auditors did not verify charges for non-biochemistry departments. Based upon the financial information provided by University personnel, the questioned costs related to non-biochemistry department charges are the 15% mark-up and the indirect costs associated to those mark-ups. These questioned costs total $192,796.

Items signed out from the storeroom for biochemistry staff were recorded in a handwritten log and not entered into the University's accounting system. To determine which expenses charged to the grants are allowable is not possible. The storeroom did not require biochemistry department staff to provide them with an account number when they signed out items from the storeroom. Neither the University nor the auditors are able to determine the amount of questioned costs within the biochemistry department.

The auditors determined that questioned costs for the purchase of supplies with grant funds range from $32,741 to $275,566. The University shut down the storeroom effective

Accepted or Implemented - continued

July 1, 2003. Failure to obtain proper approval for a storeroom and failure to adhere to related University policies and procedures resulted in questioned costs related to federal grants of a minimum of $225,537.

Response: Accepted. The unauthorized storeroom operation was closed as soon as the University learned of its existence. We have emphasized with University business managers the need to adhere to University policies and procedures regarding the operation of accounting for storerooms. In addition, we will continue to provide regular training sessions for University business managers on the correct operation of storerooms. We are developing a University-wide Accounting Compliance Plan that will include review of storeroom operations.

We do not concur with the stated range of questioned costs because it does not recognize the operating costs of the storeroom, charges for supplies used by biochemistry faculty and related indirect costs. We will report the appropriate storeroom financial information to the affected federal agencies. Our calculation of questioned costs is $32,741.

Auditor's Comment: We did not consider the operating costs of the storeroom as a reduction of questioned costs as the storeroom was not authorized by the University. We recommend the University work with the applicable federal agencies to reach an agreement on the amount of the questioned costs.

Updated Response: Accepted. We are developing a University-wide Accounting Compliance Plan that includes a review of storeroom operations. Discussions with the Office of Naval research regarding the questioned costs cited are ongoing and should be concluded shortly.

5. Implement appropriate procedures to ensure the appropriate clauses and certifications are obtained prior to the execution of all real estate lease agreements. File all real estate leases in excess of $10,000 with the Comptroller's Office as required by State guidelines. (Repeated-2003)

Findings: Real estate leases were not in accordance with guidelines nor were they all filed with the State Comptroller timely as required by law. The auditors examined 25 real estate leases and noted the following problems:

- 15 leases were not filed with the Office of the Comptroller timely. Ten of those were executed in the current fiscal year. The leases were filed from three months to one year and nine months late;
- eight leases, six from the current fiscal year, were executed after the lease term began;

- Two leases for freestanding buildings, one which was executed in the current fiscal year, did not contain an option to purchase the building or documentation that a purchase option was not feasible or in the State's best interest;
- One lease from the current fiscal year did not include the Real Estate Ownership Disclosure. In addition, 2 disclosures, one for the current fiscal year, were not properly completed;
- Three leases executed in the current fiscal year did not included the FEIN, TIN and Legal Status Disclosure;
- One lease executed during the current fiscal year involving construction did not include the Environmental Barriers Act/Handicapped Accessibility Disclosure; and
- Four of the leases entered into after January 1, 2004 did not include a certification that the lessor is not barred from contracting with State agencies due to violations of the Environmental Protection Act.

Response: Accepted. We have taken steps to review our files to ensure lease documentation is complete and leases exceeding $10,000 are filed with the State as required.

Updated Response: Accepted. All new leases signed this year contain the required certifications. Considerations given on a case by case basis to opening negotiations on existing leases to incorporate new State certifications by amendment, if such amendment can be accomplished without detriment to the other provisions of the lease. In the event an existing lease is expiring and has no further renewal options, a new lease containing updated certifications is prepared.

6. Follow generally accepted accounting principles and charge all expenses to the proper fiscal year. Invoices and accrual calculations should be reviewed by University management to determine that personnel charge expenses to the correct fiscal year.

Findings: The auditors noted instances where University personnel did not record expenses in the correct fiscal year. The auditors selected a sample of 250 expenditures from all campuses and noted five invoice vouchers were charged to the wrong fiscal year. Two invoices totaling $183 were recorded in FY04 that should have been recorded in FY03. Three invoices totaling $377 were recorded in FY05 that should have been recorded in FY04.

Updated Response: Accepted. The University distributes a year-end closing schedule to departmental units that clearly delineates all cut-off dates for processing accounts payable vouchers and invoices. Additionally, University Accounting and Financial Reporting reviews disbursements exceeding $50,000 during the lapse period to ensure appropriate recording of payable transactions.

Accepted or Implemented - concluded

7. Take the necessary steps to comply with the State Property Control Act and with the University's Business and Financial Policies and Procedures Manual by maintaining accurate property listings. Ensure the procedures are clearly understood by personnel responsible for property control within each department.

<u>**Findings:**</u> The auditors' testing of 61 items from the UIUC campus' property and equipment list and all weapons located at the Urbana campus disclosed the following:

- Two leased items were capitalized for incorrect amounts. One item's cost was overstated by $457,885 and the other's was overstated by $371;
- One item costing $3,984 had been disposed of, but was still on the property listing;
- One item costing $21,600 had been transferred to another department; however, the transfer was not communicated to the Office of Business and Financial Services;
- Three items did not have University identification tags; and
- Seven weapons were not included on the University's property listing.

<u>**Updated Response:**</u> Accepted. The University will continue its efforts to comply with property acquisition, update, and disposal requirements. The University currently provides training to campus units to inform attendees about their fiscal responsibilities regarding University property and University property and University procedures for acquisition, transfer and disposal of University property.

8. Implement procedures to ensure all contracts over $100,000 are filed with the Office of the State Comptroller in accordance with State statutes and guidelines.

<u>**Findings:**</u> Contracts were not filed with the State Comptroller timely. Of 11 contracts tested, nine were not filed with the State Comptroller timely, ranging from two months to more than four years late. State agencies are required to file contracts exceeding $10,000 with the State Comptroller within 15 calendar days after execution.

<u>**Updated Response:**</u> Implemented. The University implemented procedures, including a tracking mechanism, to ensure contracts are filed with the Office of the State Comptroller.

Emergency Purchases

The Illinois Purchasing Act (30 ILCS 505/1) states, "The principle of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts..." The law also recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption for emergencies "involving public health, public safety, or where immediate expenditure is necessary for repairs to State property in order to protect against further loss of or damage ... prevent or minimize serious disruption in State services or to insure the integrity of State records. The chief procurement officer may promulgate rules extending the circumstances by which a purchasing agency may make 'quick purchases', including but not limited to items available at a discount for a limited period of time."

State agencies are required to file an affidavit with the Auditor General for emergency procurements that are an exception to the competitive bidding requirements per the Illinois Purchasing Act. The affidavit is to set forth the circumstance requiring the emergency purchase. The Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the purchases and to comment on abuses of the exemption.

During FY04 the University of Illinois filed 18 affidavits for emergency procurements totaling $2,134,331.12 including:

- $1,310,195.40 for computer software purchases at discounted prices;
- $367,450.00 for specialized equipment at discounted prices;
- $149,628.00 for cattle;
- $106,448.00 for repairs;
- $89,104.60 for men's basketball tournament lodging and food;
- $46,270.00 for infectious waste disposal;
- $42,515.00 for bulk food; and
- $22,719.61 for harvesting services.

Headquarters Designations

The State Finance Act requires all State agencies to make semiannual headquarters reports to the Legislative Audit Commission in January and July. Each State agency is required to file reports of all of its officers and employees for whom official headquarters have been designated at any location other than that at which their official duties require them to spend the largest part of their working time. On July 15, 2004 the University of Illinois indicated that six employees spent the majority of working time at a location other than official headquarters.